

Message Text

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ACTION EB-07

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CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

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TO SECSTATE WASHDC 1407

INFO AMEMBASSY TOKYO

AMEMBASSY TAIPEI

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E.O. 11652: N/A

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SUBJ: KOREA'S ECONOMIC PROSPECTS FOR 1977

SUMMARY: THIS IS THE FIRST OF THREE TELEGRAMS DEALING WITH THE ROK'S PERFORMANCE IN 1976 AND OUR ASSESSMENT OF THE OUTLOOK FOR 1977. THE SECOND AND THIRD MESSAGES WILL DEAL RESPECTIVELY WITH DEVELOPMENTS IN THE EXTERNAL AND INTERNAL SECTORS AND GENERAL PROSPECTS IN MORE DETAIL. IN BRIEF, THE EMBASSY BELIEVES THAT THE ROK SHOULD BE ABLE TO MEET ITS GROWTH TARGETS OF 10 PERCENT IN GNP AND EXPORTS OF \$10 BILLION, BUT THAT THE MARGIN COULD POSSIBLY BE CLOSE. ECONOMIC GROWTH WILL DEPEND TO A LARGE EXTENT ON DEVELOPMENTS OUTSIDE KOREA, ESPECIALLY CONTINUED ECONOMIC GROWTH IN THE INDUSTRIAL COUNTRIES, AND NO INCREASE IN PROTECTIONIST MEASURES. IN THE EVENT OF A SIGNIFICANT SLOWDOWN IN EXPORTS, THE ROKG WILL UNDERTAKE EXPANSIONARY MEASURES TO STIMULATE THE ECONOMY. THE EXCELLENT PROGRESS MADE IN 1976 PROVIDES IT WITH A MARGIN OF SAFETY IN FOREIGN RESERVES AND GOVERNMENT REVENUES TO DO SO WITHOUT EXCESSIVE INFLATION.

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1. THE ROK ENTERS 1977 IN A MOOD OF CAUTIOUS OPTIMISM REGARDING ITS ECONOMIC PROSPECTS FOR THE COMING YEAR. THE CONSENSUS IS THAT THE SURPRISING 15.2 PERCENT GROWTH RECORDED IN 1976 WOULD BE IMPOSSIBLE TO DUPLICATE BUT THAT, BARRING SOME UNFORESEEN DEVELOPMENTS IN THE INTERNATIONAL ECONOMIC SYSTEM, REAL ECONOMIC GROWTH WILL BE AROUND 10 PERCENT, PACED, AS IN 1976, BY THE EXPORT SECTOR. ESTIMATES ON THE LATTER RANGE FROM \$9.7 BILLION

(ECONOMIC PLANNING BOARD) TO \$10.2 BILLION (BANK OF KOREA) WITH AN OFFICIAL EXPORT TARGET OF \$10 BILLION. THESE ESTIMATES ARE PROMISED ON A GROWTH IN WORLD TRADE OF 6 TO 8 PERCENT.

2. THE GOVERNMENT WILL ALSO SEEK TO STIMULATE INVESTMENT TO EXPAND AND MODERNIZE PRODUCTIVE FACILITIES AND EQUIPMENT. A TOTAL OF 588.7 BILLION WON (\$1.2 BILLION) IS TARGETED TO BE FURNISHED BY THE GOVERNMENT THROUGH THE BANKING SYSTEM AND SPECIAL FUNDS SET UP TO ASSIST INDUSTRY. INCLUDED IN THIS TOTAL IS \$275 MILLION OF GOVERNMENT FOREIGN EXCHANGE HOLDINGS TO BE UTILIZED FOR THE IMPORTATION OF CAPITAL EQUIPMENT. AS IN THE PAST SEVERAL YEARS, GOVERNMENT INVESTMENT INCENTIVES WILL BE CONCENTRATED IN HEAVY (MACHINERY, STEEL, METALS) AND CHEMICAL INDUSTRIES.

3. THE TARGETS FOR PRICES CALL FOR KEEPING THE WHOLESALE PRICE INDEX FROM INCREASING MORE THAN 10 PERCENT, THE GNP DEFLATOR MORE THAN 13 PERCENT AND THE CONSUMER PRICE INDEX 12 PERCENT. IN CONTRAST TO OTHER TARGETS, THESE MAY BE MORE DIFFICULT TO REALIZE. THE PAST FEW MONTHS HAVE SEEN INCREASES IN THE PRICES OF SEVERAL IMPORTANT ITEMS, INCLUDING AN AVERAGE INCREASE IN ELECTRICITY RATES OF 15 PERCENT AND IN MANY METAL PRODUCTS BY A RANGE OF 1.2 TO 15.2 PERCENT. RAILWAY FARES AND TELEPHONE RATES WERE RAISED JANUARY 1, AND OTHER PRICE INCREASES ARE EXPECTED SOMETIME IN THE NEW YEAR, PARTICULARLY FOR COAL AND PETROLEUM PRODUCTS. THE RECENT OPEC PRICE HIKES FOR PETROLEUM WORK OUT TO 7-8 PERCENT INCREASE IN THE ROK'S IMPORT BILL; HOWEVER, EFFORTS WILL BE MADE TO HOLD DOMESTIC PRICE INCREASES FOR EX-REFINERY PRODUCTS TO AROUND 5 PERCENT. AS THESE VARIOUS COST INCREASES WORK THEIR WAY THROUGH THE ECONOMY, INCREASED COSTS OF LIMITED OFFICIAL USE

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PRODUCTION AND ALREADY STRONG PRESSURES FOR HIGHER WAGES TO COMPENSATE FOR REDUCTIONS IN PURCHASING POWER, WILL PLACE STRAINS ON THE PRICE STRUCTURE. THE PROPOSED ADOPTION OF THE VALUE ADDED TAX (VAT) SCHEDULED FOR JULY 1, 1977 WILL ADD TO THE PROBLEMS OF PRICE STABILITY, IF EXPERIENCES ELSEWHERE ARE REPEATED IN THE ROK.

4. EMBASSY ASSESSMENT: AS NOTED ABOVE, EXCEPT PERHAPS ON THE PRICE FRONT, THE EMBASSY BELIEVES THAT THE ROK'S ECONOMIC TARGETS FOR 1977 ARE ATTAINABLE. REAL GNP GROWTH OF BETWEEN 9.5 AND 10 PERCENT IS HIGHLY PROBABLE AND COULD TURN OUT HIGHER IF THE PRESENT LEVELING OUT IN KOREA'S PRINCIPAL EXPORT MARKETS (THE UNITED STATES, JAPAN, AND THE EC COUNTRIES) ENDS SOON. IN THE EVENT LEVELING OUT ON THE EXTERNAL SIDE CONTINUES, WE EXPECT THAT THE ROKG WILL UNDERTAKE ADDITIONAL EXPANSIONARY MEASURES

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SIMILAR TO 1974 AND 75 TO STIMULATE INVESTMENT, ESPECIALLY HOUSING WHICH IS IN THE DOLDRUMS, AND EXPAND GOVERNMENT CONSUMPTION. LARGE FOREIGN EXCHANGE RESERVES AND INCREASED GOVERNMENT REVENUES PROVIDE A CUSHION TO DO THIS WITHOUT AN OVERLY EXPANSIONARY MONETARY POLICY.

5. ON THE EXTERNAL SIDE ANOTHER CLOUD ON THE HORIZON IS THE THREAT OF INCREASED PROTECTIONISM IN THE INDUSTRIALIZED COUNTRIES. THE UNILATERAL IMPORT QUOTAS ON TEXTILES ANNOUNCED BY CANADA ON NOVEMBER 29 WERE A BLOW, NOT ONLY IN THEMSELVES SINCE KOREAN EXPORTS OF TEXTILES TO CANADA ARE EXPECTED TO BE REDUCED BY 46 PERCENT IN 1977 BELOW THE PROJECTED \$170 MILLION MARK, BUT AS A POSSIBLE PORTENT OF SIMILAR ACTIONS ELSEWHERE. THE GOVERNMENT AND BUSINESSMEN ARE CLOSELY WATCHING DEVELOPMENTS IN THE EC COUNTRIES, ESPECIALLY FRANCE AND THE UK, AND THE UNITED STATES. KOREAN TEXTILE EXPORTERS ALSO NOTE INCREASED PRICE COMPETITION FROM INDIA, PRC, INDONESIA AND PAKISTAN. IN ADDITION TO TEXTILES, PROTECTIONIST THREATS AGAINST THE RAPIDLY EXPANDING ELECTRONICS INDUSTRY ARE A CONCERN.

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6. FORTUNATELY, KOREA HAS UNDERTAKEN STRENUOUS EFFORTS TO DIVERSIFY MARKETS, ESPECIALLY IN THE OIL-RICH MIDDLE EAST STATES. EXPORTS TO THIS AREA NOW ACCOUNT FOR 8 TO 9 PERCENT OF THE TOTAL, AND

THE TARGET FOR 1977 IS 12 PERCENT. IN ADDITION TO TEXTILES, IRON AND STEEL PRODUCTS AND CEMENT ARE IMPORTANT EXPORTS TO THESE COUNTRIES. OVERSEAS CONSTRUCTION CONTRACTS FOR 1977 ARE TARGETED AT \$3 BILLION, MOST OF WHICH ARE EXPECTED TO GO TO MIDDLE EASTERN PROJECTS. EFFORTS WILL ALSO BE UNDERTAKEN TO INCREASE EXPORTS TO OTHER LDC'S UNDER DEFERRED PAYMENT PLANS FINANCED BY THE ROK EXPORT-IMPORT BANK.

7. MOST INDICES OF INDUSTRIAL PRODUCTION WERE STILL MOVING UPWARD AS 1976 DREW TO A CLOSE ALTHOUGH AT DECELERATING RATES. PRODUCTION OF STEEL, ELECTRONICS AND SYNTHETIC FIBERS WERE ALL CONTINUING AT HIGH LEVELS. ON THE OTHER HAND, THE FERTILIZER INDUSTRY IS PLAGUED WITH OVERPRODUCTION: REPORTEDLY, THERE IS CLOSE TO A YEAR'S SUPPLY ON INVENTORY. THIS PROBLEM WILL BE COMPOUNDED IN 1977 WHEN THE SEVENTH FERTILIZER COMPLEX, WITH A PRODUCTION CAPACITY OF OVER A MILLION MT OF COMPOUND FERTILIZER AND UREA, COMES ON STREAM.

8. FOR MOST INDUSTRIES, HOWEVER, INVENTORIES STEADILY DECLINED THROUGHOUT 1976, WITH THE RATIO OF INVENTORIES TO SHIPMENTS FALLING FROM A HIGH OF 92 IN FEBRUARY TO 74 IN NOVEMBER. WHILE IT IS EXPECTED THAT PRODUCTION WILL CONTINUE AT HIGH LEVELS IN 1977--INDUSTRIAL PRODUCTION IS TARGETED TO INCREASE BY 17.2 PERCENT--A RECENT BANK OF KOREA SURVEY FORECAST A SLIGHT DIP IN THE PRODUCTION INDEX OF 3.5 PERCENT IN THE FIRST QUARTER AS A RESULT OF A SLOWDOWN IN SALES TO THE U.S. AND JAPAN AND SEASONAL FACTORS. THE KOREA TRADERS ASSOCIATION HAS ALSO PROJECTED A DOWNTURN IN COMMODITY EXPORTS DURING THE FIRST THREE MONTHS AS A RESULT IN A DECLINE IN THE ARRIVAL OF LETTERS OF CREDIT AND WEAKNESSES IN FOREIGN DEMAND FOR TEXTILES, ELECTRONICS, AND CERTAIN FOOD ITEMS. SIMILAR SENTIMENTS HAVE BEEN EXPRESSED IN CONVERSATIONS WITH EMBASSY OFFICERS BY KOREAN OFFICIALS AND BUSINESSMEN. ON THE OTHER HAND, EXPORTS OF CHEMICAL AND HEAVY INDUSTRIAL ITEMS, LIMITED OFFICIAL USE

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AS WELL AS SOME NON-TEXTILE LIGHT INDUSTRY PRODUCTS, ARE EXPECTED TO INCREASE SLIGHTLY. THE SECOND QUARTER WILL TELL THE STORY FOR THE YEAR'S OVERALL PERFORMANCE. A CONTINUING DOWNTREND MAY INDICATE A CYCLICAL DOWNTURN IS IN THE OFFING AND TRIGGER POLICY MEASURES PROJECTED ABOVE.

9. 1977 WILL BE THE FIRST YEAR IN WHICH ECONOMIC EFFECTS OF THE ROK FORCE IMPROVEMENT PROGRAM (FIP) AND HIGHER MILITARY OUTLAYS WILL BE EVIDENCED. WITH DEFENSE BUDGET OUTLAYS UP SOME 31 PERCENT, INCREASED DEBT SERVICE CHARGES, AND HIGHER FOREIGN EXCHANGE MILITARY EXPENDITURES, THE ESTIMATED OVERALL REAL GROWTH WILL BE REDUCED A MAXIMUM OF 0.4 PERCENT IN 1977 FROM WHAT IT WOULD HAVE BEEN OTHERWISE.

10. ON A STATISTICAL TREND BASIS ALONE, GNP GROWTH IN 1977 COULD

BE EXPECTED TO INCREASE BY 8.75 PERCENT IN REAL TERMS. HOWEVER, TAKING THE VARIOUS ELEMENTS NOTED ABOVE AS WELL AS THE CYCLICAL COMPONENT, IT APPEARS THAT 9.8 PERCENT WOULD BE A MORE REALISTIC PROJECTION. CONSEQUENTLY, THE ROK TARGET OF 10 PERCENT APPEARS FEASIBLE UNDER ALL BUT THE MOST UNFAVORABLE CIRCUMSTANCES. AS IN 1976 THE PERFORMANCE OF THE EXPORT SECTOR, WHICH ACCOUNTS FOR BETWEEN 30 AND 40 PERCENT OF THE GNP GROWTH, WILL BE THE DECISIVE ELEMENT IN THE COUNTRY'S ECONOMIC PROGRESS. (EMBASSY ASSESSMENT OF KOREA'S EXPORT PERFORMANCE AND BALANCE OF PAYMENT PROJECTIONS WILL BE CONTAINED IN OUR WRAP-UP OF THE ROK'S 1976 EXTERNAL PERFORMANCE).

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